

IN THE COURT OF APPEALS OF TENNESSEE  
AT KNOXVILLE

Submitted on Briefs August 4, 2009

**JOHNNY R. PHILLIPS v. KY-TENN OIL, INC.**

**Appeal from the Chancery Court for Scott County**  
**No. 9709     Billy Joe White, Chancellor**

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**No. E2008-02724-COA-R3-CV - FILED SEPTEMBER 25, 2009**

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In this action to terminate an oil and gas lease, the plaintiff sought a declaration that the lease had expired and a judgment in the amount of \$500,000.00 for slander of title, along with an award of attorney's fees. Following a bench trial, the court dismissed all of the plaintiff's claims with prejudice, declaring the oil and gas lease to remain in full force and effect as to all real property covered by the lease. The plaintiff appeals. We affirm.

**Tenn. R. App. P. 3 Appeal as of Right; Judgment of the Chancery Court**  
**Affirmed; Case Remanded**

JOHN W. McCLARTY, J., delivered the opinion of the court, in which HERSCHEL P. FRANKS, P.J., and CHARLES D. SUSANO, JR., J., joined.

Johnny V. Dunaway, LaFollette, Tennessee, for Appellant, Johnny R. Phillips.

Stephen A. Marcum, Huntsville, Tennessee, for Appellee, KY-TENN Oil, Inc.

**OPINION**

**I. BACKGROUND**

On February 10, 1998, Appellant Johnny R. Phillips acquired three tracts of real property, described in the Kane deed of record in Warranty Deed Book 138 at Page 451 in the Register's Office for Scott County, Tennessee. The three tracts were part of a total conveyance of approximately 4,500 acres from the Estate of Maurice Kane through an Executor's Deed. Mr. Phillips immediately conveyed all but the three tracts described in Warranty Deed Book 138 at Page 451 to third parties, Charles D. and W.T. Strunk.

Mr. Phillips's predecessor in interest, Mr. Kane, had entered into an oil and gas lease ("Lease") with Bill Ray, the lessee at the time, on December 8, 1976. The Lease provided the pertinent development conditions for its continuation in paragraph two:

It is agreed that this lease shall remain in force for a term of two (2) years from this date and as long thereafter as oil, gas, casing-head gas, casing-head gasoline or any of them is produced from said leased premises or operations for drilling are continued as hereinafter provided, or operations are continued for the injection of water, brine and other fluids into subsurface starts.

The Lease applied to all of the tracts purchased by Mr. Phillips in 1998.

In a 1990 ruling, the Chancery Court of Scott County had upheld the Lease, dismissing a complaint brought by Mr. Kane and declaring the Lease “valid and binding on all parties and their assigns.” *Kane v. Ray*, Docket No. 4893. The appellee in the present action, KY-TENN Oil, Inc., is the successor lessee to Mr. Ray, having been assigned the Lease and all well interests by Kingston Oil Corporation on August 17, 2004.

In 2006, Mr. Phillips conveyed one of the three tracts (146 acres) to William Fitzgerald and his wife, Sabrina Fitzgerald, and Carol Fitzgerald. The warranty deed transferring property from Mr. Phillips to the Fitzgeralds included the following clause regarding “Tract IV”:

This conveyance is made subject to Oil and Gas Lease from Maurice Kane to Bill Ray, dated December 8, 1976, and recorded in Misc. Book 48, Page 540, in the Register’s Office for Scott County, Tennessee, on April 19, 1977, and all assignments, thereof.

Mr. Phillips owns the two remaining tracts of land at issue in this action, described as Tax Map 072, Parcel 008.00 (18.77 acres) and Tax Map 071, Parcel 037.00 (1,121.98 acres). The Fitzgeralds are not parties in this action.

The Lease included an entirety clause at paragraph twelve to address potential division of ownership:

If the leased premises are now, or shall hereafter be, owned in severalty or in separate tracts, the premises nevertheless shall be developed and operated as one lease, and all royalties accruing hereunder shall be treated as an entirety and shall be divided among, and paid to, such separate owners in the proportion that the acreage owned by each such owner bears to the entire leased acreage: Provided however, if the leased premises consist of two or more non-abutting tracts, this paragraph shall apply separately to each such non-abutting tract, and further provided that if a portion of the leased premises is hereafter consolidated with other lands for the purpose of operating the consolidated tract as one lease, this paragraph shall be inoperative as to such portion so consolidated.

At the time of trial, the parties stipulated that “[t]he lands described in Deed Book 138, at Page 451 do not abut the lands described in Deed Book 139, at Page 1 [the Strunk property]; and [t]he three (3) tracts of land described in Deed Book 138, at Page 451 do not abut each other.”

KY-TENN's predecessor in interest, Kingston Oil and Gas, drilled two wells on Mr. Phillips's property, but the wells were not subsequently developed. Regarding development and production of oil and gas on land covered by the Lease, the parties stipulated at the time of trial:

There has been no exploration, development, production, marketing or royalties of oil and gas with respect to the three (3) tracts of land described in Deed Book 138, at Page 451 since 1978; and

There has been commercial production of natural gas from the Kane lease from lands other than the three (3) tracts of land described in Deed Book 138, at Page 451 from 1996 through the date of this stipulation.

The present dispute arose when Mr. Phillips contacted Bill Goodwin, President of KY-TENN, in an effort to procure release of the three tracts of land from the Lease. In March 2005, correspondence between Mr. Goodwin and Mr. Phillips's attorney at the time, T. Michael O'Mara, indicated that Mr. Phillips had obtained what both parties characterized as a "tentative" agreement for Mr. Goodwin to facilitate such a release. According to subsequent correspondence, Mr. Goodwin proposed the release to the KY-TENN Board of Directors, but the Board members refused. In a letter to Mr. Goodwin, dated June 15, 2006 (two days before the final sale of the 146-acre tract to the Fitzgeralds), Mr. O'Mara "demand[ed]" release of the land but also noted that the Board's refusal had been communicated to Mr. Phillips: "In the past your company had tentatively agreed to release the acreage but now has concluded that it will not do so." In subsequent correspondence, the parties were unable to reach an agreement that would result in release of any of the three tracts.

Mr. Goodwin's first request in the record for access to the property was in a letter to Mr. O'Mara, dated July 4, 2006. Mr. Phillips responded on July 18, 2006, through Mr. O'Mara, that he would be willing to allow KY-TENN access only to the two existing wells on the property in return for "a release of all undrilled acreage." In a letter dated August 15, 2006, Mr. Goodwin refused this proposal and again requested access to the land. In March 2007, the parties again corresponded but were unable to resolve the dispute. Mr. Phillips, now represented by his present attorney, requested "a full release of his acreage" from the Lease. Mr. Goodwin offered to release the 146-acre tract, now belonging to the Fitzgeralds, in return for no further action on Mr. Phillips's part to procure release of the other two tracts. In his letter dated March 20, 2007, Mr. Goodwin agreed that his company had not produced or explored on Mr. Phillips's property, stating, "He made us very aware that he really didn't want anyone on that property and we honored his wishes."

Mr. Phillips subsequently filed a complaint in the Chancery Court of Scott County on April 4, 2007, requesting declaratory judgment that the Lease had expired, damages in the amount of \$500,000 for slander of title, and litigation expenses. In a judgment entered on November 18, 2008, the trial court concluded that an entirety clause "is not an offensive weapon that can be used to bring in the implied covenants to produce in order to terminate the lease as to a portion of the leased property" and that in this case, KY-TENN had been "kept from production by the land owner denying access." The court dismissed all of Mr. Phillips's claims with prejudice and ordered that the Lease remain "in full force and effect as to all real property covered by the lease."

Mr. Phillips filed a timely appeal to this court on December 8, 2008.

## **II. ISSUES**

We restate the issues as follows:

- A. Whether the trial court erred in holding that the entirety clause in the Lease cannot be used offensively to terminate the Lease when the property at issue is comprised of non-abutting tracts, for which the Lease states that the entirety clause applies separately.
- B. Whether the trial court erred in holding that KY-TENN had not broken implied production, exploration, development and operation covenants in the Lease when it is undisputed that KY-TENN was producing natural gas in commercial quantities from other tracts covered by the Lease at the time of trial and that prior to the trial, Mr. Phillips had denied KY-TENN access to the tracts owned by Mr. Phillips.

## **III. STANDARD OF REVIEW**

This case was tried by the court without a jury. Our review, therefore, is de novo upon the record of the proceedings below with a presumption of correctness as to the findings of fact of the trial court. *See* Tenn. R. App. R. 13(d); *Boarman v. Jaynes*, 109 S.W.3d 286, 289-90 (Tenn. 2003). The judgment of the trial court should be affirmed, absent errors of law, unless the preponderance of the evidence is against those findings. *Bogan v. Bogan*, 60 S.W.3d 721, 727 (Tenn. 2001). A trial court's conclusions of law are subject to de novo review with no presumption of correctness. *See Campbell v. Florida Steel Corp.*, 919 S.W.2d 26, 35 (Tenn. 1996); *Presley v. Bennett*, 860 S.W.2d 857, 859 (Tenn. 1993).

## IV. ANALYSIS

### A. ENTIRETY CLAUSE

The Tennessee Supreme Court has held that oil and gas leases should be “construed most favorably to development” of the leased property. *Waddle v. Lucky Strike Oil Co.*, 551 S.W.2d 323, 326 (Tenn. 1977) (quoting *Mountain States Oil Corp. v. Sandoval*, 125 P.2d 964 (Colo. 1942)). Mr. Phillips is correct in citing the *Waddle* decision for this general premise. However, in relying on the *Waddle* precedent, Mr. Phillips fails to distinguish the facts in that case from those presently at issue. In *Waddle*, the court held that an oil and gas lease had terminated because the lessee had failed to perform duties that were delineated specifically in the lease, such as to “begin operations for the drilling of a well *within six months*.” 551 S.W.2d at 324-26 (emphasis added). The *Waddle* court further stated that “if the conditions *expressly provided* to avoid termination are not performed, then termination is the result. . . .” *Id.* at 327 (emphasis added). Thus, in order for the Lease to terminate according to its own provisions, those provisions would have to expressly provide that nonperformance of certain conditions would warrant termination.

In this case, the parties stipulated and the trial court concluded as a factual matter that “There ha[d] been commercial production of natural gas from the Kane lease from lands other than the three (3) tracts of land described in Warranty Deed 138 at Page 451 from 1996 through the date of trial.” Therefore, with the land covered by the Lease considered as a whole, at the time of trial, the lessee was still fulfilling the condition stated in paragraph two of the Lease to avoid termination: “as long [after the initial two-year period] as oil, gas, casing-head gasoline or any of them is produced from said leased premises or operations for drilling are continued. . . .” The issue then becomes whether the entirety clause at paragraph twelve of the lease can be used by Mr. Phillips to divide the three tracts described in Warranty Deed 138 at Page 451 from the rest of the land covered by the Lease. There was no entirety clause involved in the *Waddle* dispute, so Mr. Phillips’s reliance on that precedent is unavailing on this issue. *See Waddle*, 551 S.W.2d 323.

“An oil and gas lease is subject to the well established rule that in the construction of contracts, wills, deeds and other instruments in writing, the court seeks to ascertain the intention of the parties from the language used.” *Id.* at 326 (citing *Lamczyk v. Allen*, 134 N.E.2d 753 (1956)). This court has previously held that “[A]bsent an agreement to the contrary, oil and gas leases are not divisible. Production on any portion of the leased premises after expiration of the primary term will hold the entire lease in effect.” *Mitchell Energy Corp. v. Windle*, No. 01-A-01-9111-CH00430, 1560, 1992 WL 163401, at \*6 (Tenn. Ct. App. M.S., July 15, 1992) (citing *Mathews v. Sun Oil Co.*, 425 S.W.2d 330 (Tex. 1968); *Wilson v. Purnell*, 250 S.W.850 (Ky. 1923)). The *Mitchell Energy* court held that the oil and gas lease remained in effect in part because there were no provisions in the lease for development of the various tracts involved to be considered separately. 1992 WL 163401, at \*6. However, in *Young v. Dixie Oil Co.*, this court upheld release of acreage that was not committed to “the one well drilled on that tract” because the lease for that tract included the express provision that the “shut in gas well holds only acreage committed to each well.” 647 S.W.2d 235, 236-37 (Tenn. Ct. App. 1983). In *Young*, this express provision constituted an “agreement to the

contrary” sufficient to divide the oil and gas lease. *Id.* at 237. The issue in the present case then narrows to whether the entirety clause in the Lease constitutes such an agreement, contrary to the general provisions of the lease, sufficient to divide the Lease.

Neither party has cited, and we have not found, a Tennessee precedent on point for whether an entirety clause may be used offensively to terminate an oil and gas lease. KY-TENN has referenced several cases from other states that address the function of an entirety clause. The Supreme Court of Texas has held that an entirety clause, written as “subject to” the rest of the lease, “limits and qualifies” the lease but does not void the lease as a whole. *Cockrell v. Texas Gulf Sulphur Co.*, 299 S.W.2d 672, 677 (Tex. 1956). The purpose of the entirety clause has been defined as providing for the equitable apportionment of royalties when the land covered by an oil and gas lease is subsequently owned in separate tracts. *Jul-Tex Drilling Co., Inc. v. The Pure Oil Co.*, 201 F.Supp. 874, 877 (D. Colo. 1962) (citing 3A Summers Oil and Gas, Section 609 (2d Ed.)); *see also Cockrell*, 299 S.W.2d at 678 (holding that “the entirety clauses in the leases are effective so as to require the royalty reservations in the deed to be applied on the apportionment basis”); *Ruthven & Co. v. Pan Am. Petroleum Corp.*, 482 P.2d 28, 31-32 (Kan. 1971) (quoting 3 Kuntz, Oil and Gas, section 45.4) (defining the effect of an entirety clause as “overcom[ing] the nonapportionment rule,” which without the entirety clause, would exclude “lessors who own parts of the leased premises where there is no well” from collecting royalties). Acknowledging the purpose of the entirety lease as one of apportioning royalties, we hold that the trial court did not error in concluding that an entirety clause was not to be used as a termination device.

The entirety clause of the Lease clearly includes its purpose of apportioning royalties in the first section of paragraph twelve:

If the leased premises are now, or shall hereafter be, owned in severalty or in separate tracts, the premises nevertheless shall be developed and operated as one lease, and all royalties accruing hereunder shall be treated as an entirety and shall be divided among, and paid to, such separate owners in the proportion that the acreage owned by each such owner bears to the entire leased acreage:

This section ends with a colon, pointing forward to the next clause, which is the one at issue: “Provided however, if the leased premises consist of two or more non-abutting tracts, this paragraph shall apply separately to each such non-abutting tract. . . .” The parties stipulated and the trial court found as a matter of fact that the three tracts of land described in Warranty Deed Book 138 at Page 451 “do not abut the leased lands described in Warranty Deed Book 139 at Page 1” and “do not abut each other.” Therefore, the section (“paragraph”) preceding the colon, quoted above, applies separately to each of the non-abutting tracts at issue. This means that each owner of a non-abutting tract is entitled to royalties under the Lease according to the proportion of the total acreage that his or her land represents. The provision for non-abutting tracts in no way states that the entire Lease shall apply separately to each tract but only that “this paragraph” shall apply separately. *See Cockrell*, 299 S.W.2d at 677 (holding that the entirety clause “limited and qualified the sulphur royalty” and that to apply the entirety clause more broadly would create a “repugnancy” between the

entirety clause and the deed, which would result “in setting aside the entirety clause”) (emphasis added)).<sup>1</sup> The trial court found that the entirety clause in the Lease could not be used to terminate the Lease on the three non-abutting tracts at issue. The evidence does not preponderate against this finding.

## **B. IMPLIED COVENANTS**

Mr. Phillips also raises the issue on appeal of whether the trial court erred in upholding the Lease when KY-TENN had not operated and developed Mr. Phillips’s tracts of land beyond the two wells initially drilled by Kingston Oil and Gas. Mr. Phillips argues that KY-TENN has failed to fulfill the implied covenants of oil and gas leases in Tennessee. We disagree.

“Implied covenants against the lessee comprise an important phase of the law of oil and gas.” *Waddle*, 551 S.W.2d at 327. In *Waddle*, the Tennessee Supreme Court noted the following implied covenants possible in an oil and gas lease: “(1) to drill an exploratory well; (2) to drill off-set wells; (3) to drill additional wells during and after the exploratory period; and (4) to diligently operate and market.” *Id.* (quoting M. Merrill, *Covenants Implied in Oil and Gas Leases*, section 4 (2d ed. 1940); Kulp, *Oil and Gas Rights* (1954), sections 10.66-10.71)). However, “specific conditions set forth in the lease” must be given precedence over any generally implied covenants. *Waddle*, 551 S.W.2d at 327. The Lease provides in paragraph two that the lease will remain in effect as long as “oil, gas, casing-head gas, casing-head gasoline or *any of them* is produced from said leased premises or operations for drilling are continued. . . .” (emphasis added). The parties stipulated and the trial court concluded as a matter of fact that there had been “commercial production of natural gas from the Kane lease” from tracts other than those owned by Mr. Phillips “through the date of the trial.”

The trial court also concluded that KY-TENN “ha[d] been kept from production by the land owner [Mr. Phillips] denying access” to his tracts of land. Mr. Phillips admits in his brief that he has denied KY-TENN access to the tracts but defends this action as because KY-TENN had “failed to take any action with respect to those lands for the preceding twenty-five (25) years, in effect terminating their lease.” Despite Mr. Phillips’s interpretation of the Lease, it was upheld in a previous action brought by his predecessor in interest, and it had never been declared void by any court of law. The record shows correspondence between the parties in which Mr. Goodwin of KY-TENN repeatedly requested access to the property and that access was denied by Mr. Phillips’s representative. We conclude that the evidence does not preponderate against the trial court’s finding that Mr. Phillips denied KY-TENN access to his tracts of land.

The trial court’s finding regarding denial of access to Mr. Phillips’s land strengthens KY-TENN’s argument for upholding the Lease, but even without that finding, we would affirm the trial

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<sup>1</sup>Because no consolidation of tracts is at issue, the last provision of the entirety clause regarding consolidation is irrelevant to this action.

court's ruling that the Lease be upheld. Because the entirety clause applies to the apportionment of royalties and cannot be used to divide the Lease, KY-TENN's commercial production of natural gas on the tracts of land not owned by Mr. Phillips fulfills the requirements stated in the Lease to keep it in force.<sup>2</sup>

## V. CONCLUSION

The proof in this case is that by continuing commercial production of natural gas on the property, KY-TENN has fulfilled the provisions required by the Lease to continue the Lease's effect on all tracts of land originally included in it. The entirety clause, paragraph twelve, provides for the apportionment of royalties to owners of separate tracts of land with a provision that royalty distribution will apply separately to non-abutting tracts. The entirety clause does not indicate a divisible Lease and cannot be used offensively to terminate the Lease on any of the separately owned tracts. The trial court's holding that the Lease remains in full force and effect as to all leased property is affirmed. We further affirm the trial court's award of costs. Thus, the trial court's judgment is affirmed in its entirety. The cause is remanded to the trial court for collection of costs below. The costs on appeal are assessed against the Appellant, Johnny R. Phillips.

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JOHN W. McCLARTY, JUDGE

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<sup>2</sup>Mr. Phillips did not raise the argument on appeal for slander of title, which stemmed from a claim of reliance on Mr. Goodwin's alleged oral assurance that the tract sold to the Fitzgeralds would be released from the Lease. The trial court dismissed this claim, and we note that the record includes a warranty deed signed by the Fitzgeralds that conveys their tract of land "subject to Oil and Gas Lease from Maurice Kane to Bill Ray."